THE SOURCE OF FINANCIAL POWER

Complaints against Wall Street are so ancient, common, and persistent that that street is really become a sort of metaphorical wall from behind which the discontented habitually shoot their political game. The more, therefore, that we know about Wall Street, the more are we in condition to weigh judicially these complaints. In principle there is nothing done by Wall Street that is not done in most other money centers, even in those that are quite small. The question is one of degree. Wall Street is the central point where schemes, rightly or wrongly open to criticism, are organized, which are of national magnitude. There is no social institution but stands in need of constant criticism, and it is but natural to select the central ganglion of finance as typical of all the ganglia. One of the most criticised classes of acts is that of dealing in stocks and bonds. With that we have little to do in the present paper. Another and related class of acts consists in the founding of commercial and industrial undertakings by means of the support of great capitalists, financiers, and banks before the securities are put on the market. This side of Wall Street activities is somewhat nearer our quest. The part which the stock exchange plays in the launching of industrial enterprises will come in for merely incidental notice, although that part is very important. New securities, or those of corporations in course of reorganization, are those most dealt in on the exchange. The oldest and best-tested securities are held for investment, and frequently disappear entirely from the stock market.

Our inquiry is as to the source, extent, and nature of the power possessed by the great capitalists and recognized leaders of finance. The inquiry is, of course, entirely abstract. It is not a history of the financial operations of particular persons, but it is an inquiry as to why such men possess and wield their power, and as to the nature of power that flows from the source we may discover.

These men are possessed of a double character: they are partly capitalists and partly promoters. As capitalists they are men of wealth, and as promoters they are men using the wealth of others. We have to inquire into the nature of wealth, as it is understood from the point of view of finance. When one has once reached some conclusion about that, he may draw such further inferences as he chooses as to the moral, political, or economic effects of the fact that they use other people's wealth as well as their own. The fundamental suspicion on the part of the public resolves itself into an inquiry as to whether the magnates of Wall Street are gradually absorbing all the wealth of the country, or whether, again, they are exercising an undue influence over other people's wealth. As already stated, the answer to these pertinent questions necessarily involves a careful study of wealth in the financial sense; and it is hardly necessary to add that when once we have cleared up the question of the nature of financial wealth, the theoretical position of these gentlemen in the financial system of the day will be found to be fairly self-explanatory.

Financial wealth consists in promises and in nothing else. The gold which financiers keep in their reserves is in no strict sense a part of their financial wealth, but is material capital practically convenient in their business, but, on the pure theory of finance, not of the essence of it. The science of political economy has neglected this important branch of theory. Political economy has always been defined as a science treating of material goods alone — their production, exchange, distribution, and consumption. The economist has cautiously limited himself to the following of material goods through their career of utility to man, and to describing in general terms the ways in which those material goods act, as it were, in supplying man's wants. For instance, it is not possible that the income of the different classes of producers should exceed in quantity the total of the goods which their combined efforts produce. Again, it is reasonable to suppose that each class of producers and each member of each class receives as income such of the common products as the efficiency of the class or individual draws to himself; and in such a way

that, if we take the sum of all of the goods that all severally receive, they will equal the common products aforementioned.

This reasoning is legitimate and serves to set off the physical possibilities of economic life in a category by themselves; and this category has been appropriated as the peculiar field of economics. "Orthodox political economy" may therefore be defined as the science of the materialistic possibilities of production, exchange, distribution, etc. Regarded biologically, it deals with the environment of industry. We have here only a science of economico-physical limits. Undoubtedly this is the most fundamental, and hence most important, part of theory. But it is only a part — a static part — of economics. The science should not be satisfied until it has explained the whole of the economic process as a process. Consequently, all systematic works on economic theory devote a portion — an inadequate portion — to the explanation of the other part, namely: What is the economico-technical process by which the goods are distributed? The technical means of production consists of many machines, including the machines that transport goods. The technical means of distribution consists in financial machinery. Without criticising the explanations given by others, I shall endeavor to explain this machinery and its bearings on the question of financial power, by looking at the facts directly and at first hand.

What is the nature of financial wealth? While the theories of value and of distribution treat only of materialistic premises, it is a striking fact that many men of wealth never come in contact with material things. Their subject-matter is entirely immaterial, although they use materialistic terms. The farmer's land, tools, grain, and cattle constitute his wealth. The financier thinks of his notes and bills and stocks and bonds as items of wealth in precisely the same way: whereas really what he possesses is simply promises. Promises and nothing but promises are the alpha and omega of finance. The business of promising is therefore the real object of our study, which is to be a description and a synthesis of promises. Capital is said to be abundant or deficient in Wall Street; this means that promises are abundant or deficient.

Naturally, these promises are not the unclassifiable promises of lovers or politicians, but promises about the goods with which the theory of political economy is concerned. Our inquiry is, therefore, as to how these promises originate, how they change their form and change hands, and how they become a great moral force carrying with them the direction of industrial affairs.

Let us begin with some of the simplest economic promises and observe their history and functions. Bills and notes arise in the course of production of goods. It is sometimes stated that business should be carried on entirely upon cash, and that, if this were done, crises would be avoided. A little reflection will show the impossibility of the proposition. The producer seeks the greatest certainty in his operations. He wants to know that his goods will be sold before he buys the raw materials out of which they are to be made. If he waits until they are manufactured, and then depends upon selling them for cash, he is not sure of selling them at all. If, however, he can obtain a guaranty of some sort that his goods are to be sold, he will go ahead and manufacture. Rather than pay cash, therefore, for his raw materials, he goes to a bank and in effect, by discounting his note, obtains a guaranty of his business sanity, solvency, and dependableness. To be sure, the operation of discount is not ordinarily looked upon in this way. It is said that the manufacturer discounts his note because he has not the ready money, and in order to save the necessity of having a portion of his wealth invested in money. Bank discount is the method of saving a certain amount of material capital. This explanation is also true, and may explain the more personal motive. But from a wider social point of view there can be no question but that the notes of manufacturers form a series of contracts which certify to the amount of production that is going on and afford a measure of that production, and which, when discounted at a bank, receive the sanction of the bank to the belief that the goods are needed and will be sold. It is true that the bank keeps the note and gives in exchange its own demand promises, which enter into circulation. But this exchange of obligations is as truly a guaranty as is an indorsement.

Instead of supposing our manufacturer to be starting in business without any money capital, let us suppose one who has already manufactured one batch of goods. In other words, he has already run through his machinery enough raw material to employ all the machinery from the beginning to the end of the process, and to turn out as much product as it is worth while turning out, if he is to start up his machinery at all. The time taken to produce this amount of goods is a production period. Now let us suppose him, as in the first instance, to be without money and to desire to keep his business a-going. Of course, he must sell the first batch of goods in order to buy a new batch of raw material. Does he sell the first batch for money? Certainly not. He has little object in doing so. Having sold the goods, he takes a note with interest for their price. How long does the note run? Why, for a production period, or until the second batch of goods shall have matured.[1] Then, in case the note is not paid, he is able to make good his guaranty on it as an indorser, he having in the meanwhile discounted the note at the bank in order to purchase fresh materials. If the note had been made for a less time than the period of production, he might have been called upon to pay it before the second batch of goods was finished, and he would have been unable to liquidate. He would not have been in a position to borrow money on goods produced, but would have had to borrow upon his plant—a proceeding obviously unbusinesslike. And if he had taken a note that ran for a period longer than the period of production, he would, in similar

[1] The statement that short-time loans and discounts run for a productive period is one of those untruths which have to be stated in order to demonstrate the truth. The statement is untrue because no manufacturer, for example, borrows for a period exactly equal to *his* production period. The explanation is that the market for promises normalizes the loans, within a certain range of business, to a certain time to run. But the businesses in which this paper arises are those having production periods that are not widely different, so that it still holds true that the production periods and the loan period correspond approximately. A rough correspondence, or even a relative correspondence (the notes, e. g., in a particular business being always so many days longer or shorter than *its* production period), is probably all that needs to be proven in an argument as to the economic effect of these financial contracts. The method of argument here employed is that of the "representative firm," rather than that of the "economic man."

case of failure on the part of the maker of the note to pay the bank, be compelled to pay interest for an unnecessarily long period, or would again find himself out of funds because the proceeds of the second batch of goods had been already invested. The conclusion is that commercial paper of this sort must be drawn for a period equal to the period of production.

If we drop for a moment our typical manufacturer and look at industry as a whole, we find that the necessity of a correspondence between the production period and the time that bills and notes run, is still more obvious. Socially speaking, commercial paper forms a complex of contracts which binds together the whole industrial world and gives certainty to the transactions of production and distribution. It is of the highest importance that the exact amount of production be adjusted as nearly as possible to the fluctuations of demand. It is safe to say, indeed, that the mass of these contracts is not made with the final wholesalers, jobbers, and distributers for consumption. On the contrary, they are made between producers of different degrees of remoteness from the finished product, one set selling to another set (the product of the first being the raw material of the second) until, after passing through many independent establishments, which represent successive stages of production, the goods are ready for final consumption. The earlier producers sell to many different lines of industry. The later producers buy their raw materials from many different manufacturers of half-finished products. When we consider the thousands and thousands of different kinds of goods in the way of foods, textiles, buildings, and the various services of lodging, transportation, heating, lighting, amusement, and the interminable maze and criss-cross of business contracts vertical and diagonal through all the depth and breadth of the vast field of supply, it is obvious that this infinitely complex network of production needs to be held in place by some system which shall give to it the tmost certainty compatible with a high degree of flexibility in its adaptation to the fluctuations of demand.

Commercial paper performs this invaluable service; and yet it is never thought of in this way. Commercial paper is looked

upon as a promise to pay so much money; at least, that is the way it is treated in the courts of law. But it must now be evident that, from a broad and social point of view, the essential thing is the contract for production and sale, and not the contract for the payment of money. The slightest knowledge of affairs teaches us that the nominal contract is exacted only in very exceptional cases. How does the giver of the note pay his note when it is due? In cash? Certainly not; nobody exacts that of him. Legally, everybody may do so, but by custom he may prove his solvency by simply liquidating his note according to the unwritten law of merchants. In other words, he substitutes for it the promise of a banker or some other person whose promise is more generally current than his own; or, if his note has expired, he substitutes a new note given for new production, undertaken, however, by another, though not a more responsible, manufacturer or business man. Such a promise is accepted, not by legal sanction, but by the custom of merchants, because of the social utility of such acceptance. The substitution of credit better than your own, or even of fresh credit of another, is really a liquidation, and is final unless some hitch or failure occurs in the series of transactions, in which case a whole row of liquidations, perhaps, must be invalidated and actual money may be substituted.

Thus far we have only shown that business promises bind industry together, so that all private industries are, as it were, melted up into one great social industry. As the complexness of these relations surpasses the imagination, it is also evident that they could not be codified by any socialistic state regulation. Commercial paper constitutes the abbreviated contracts which have this effect of solidarity. It is payable in money and assignable by indorsement. It was not until comparatively recent times that the law merchant was amalgamated into the English common law, which thus at last recognized the validity of such assignments without a formal novation on the part of the promisor. The *practice* of merchants, however, had been of the character indicated from very early times; and not merely is this practice a convenience from the individual's point of view, but it furnishes

an elasticity to the contract system without which the vast modern development of the latter would have been impossible. Let us again take our typical manufacturer as an example. He takes a note for his first bill of goods, and that puts him in funds to buy fresh raw materials and to pay his laborers. He may, indeed, retain that note until it is due, but in practice he is not likely to do so. More probably he will assign the note to the vendor of the raw materials and in that way pay for them. Doubtless the vendor would rather have the note in question, indorsed as it is by our manufacturer, than the latter's own note. The operation of assigning the note simplifies matters, for now there is only one note to be collected, whereas otherwise there would have been two. The vendor of the raw materials may assign the note again for value received, having added his own indorsement, and having thus again effected for society a saving of labor of superintendence.

If we thus follow the history of the note for a time, that document loses its personal character and acquires a social one. It is become a social means of payment. Its value no longer consists in the reliance of an original A on the promise of an original B, but, within quite a range of transactions and for a certain class of business, it is become an unquestioned means of purchase and payment. Going farther, we may imagine that a class of such documents is created. It makes no difference in what sort of a business the particular document was first created, it will pay debts in any business within a customary and habitual range of trades and localities.

Now let us make a different supposition. Suppose that our manufacturer does not pay for raw material with the note, but holds it as an investment until maturity. He then presents it to the purchaser of his wares for payment. Does he expect the latter to pay him gold or other legal tender according to the "nomination of the bond?" Not necessarily. He kept the note for investment, and does not care for dead and useless goods, such as gold or silver. Instead of that, he is glad to accept from the purchaser a note of one of the latter's purchasers, and thus his investment is not interrupted.

But now let us suppose that the note with which we started cannot be paid at maturity. Suppose that our manufacturer does not wish to continue his investment and asks for cash, which the purchaser is unable to furnish. This is strictly a case of business failure, for the contract was to pay legal tender. The debtor, however, may go to some person of wealth accustomed to taking business risks, and, for an extra compensation in the way of interest, may obtain for himself first-rate paper with all the quality of currency that may be desired, and with that he may satisfy his creditor directly or by obtaining cash for the paper at a bank. The last paper or note mentioned belongs to a somewhat different class from the others. For purposes of circulation it is perhaps better, because made by a man having a solid reputation for wealth. But it was not made in the course of payment for goods. It does not, therefore, directly bind a bargain of manufacture and sale. It does not, primarily, cement together the industrial fabric. It is, indeed, made on the strength of the general solvency of a certain party; but it is not quite certain that such a note corresponds to a given quantity of production; and if we take the whole mass of notes made in a given department of commerce, and reflect that among them must be many of the uncertain character alluded to, it must be evident that there is not an exact parallelism between the production of goods and the production of promises. Therefore the whole volume of promises may somewhat exceed in their nominal value that of the initial expected value of the goods of the given production period. There is thus introduced a certain extra elasticity — a certain "extension" credit[2] — into the system of promises. For the theory of prices this elasticity is very important; for since all the promises enter into general circulation and become general purchasing power, it is evident that in short periods, before a corrective can be administered, there will be a decided influence exerted upon prices by promises that are in effect loans and not sales of goods.

It is not necessary, however, that such influence should be

[2] To be distinguished carefully from the normal elasticity involved in a strict parallelism of production and mercantile paper — the rising and falling of the latter *pari passu* with the former.

exerted. But it is not the purpose of this paper to enter into the theory of prices. Our topic is little more than that of the generalization of credit. The falling through of the plans of a manufacturer, his disappointment in making sales, the unexpected concessions to which he may feel himself forced in the matter of wages, the thousand unforeseen contingencies, perhaps outside of his control, perhaps the offspring of his own foolishness or infatuation — all these causes conspire to injure his power of liquidation in current marketable promises. Yet his case may not be absolutely desperate, and the promise that he hires may be no more than a fair equivalent for the value of the goods he is at the time in the course of producing. The "money-lender" gave him credit simply because it was expected that by the ripening of another production period full value would be realized. It therefore still holds true that there is a rough parallelism between goods and promises.

Goods are generalized in the market for goods; that is to say, such products as corn are graded and sold by sample, and, making an allowance for certain fixed differences, corn from one section will make good delivery on a purchase of corn in general at the central market. There are no goods that are not in some sense graded, although not amenable to a technical system of grading like agricultural products. The existence of a market for goods proves that all goods are graded; that is, they acquire a general value. Even land ranges higher in some localities than in others, allowance made for differences in special lots.

The same generalizing process takes place in the case of promises, but in a higher degree. The so-called money market is a market for promises. There promises are graded; they are known as one-name, two-name, three-name, etc., paper; as thirty-day, sixty-day, ninety-day paper; as gilt-edge, first- and second-class, and so on; and yet, making an allowance for fixed differences in each class, we may speak of a general market for paper, in which all negotiable promises are reduced to the simplest terms and to a homogeneous mass. In fact, the differences between different kinds of paper are much fewer than those

between goods. Goods are almost infinite in kinds; but all the promises of the money and securities market could be reduced to perhaps a few dozen different kinds. The reason for this is palpably that the same kind of paper may arise in the production of a vast variety of goods.

We thus arrive at the remarkable conclusion that by the mechanism of the money market the values of all goods, however different in kind, are reduced to an almost homogeneous mass. The whole income of the country, with the exception of the elastic element alluded to above, is represented by the existing mass of commercial paper. It makes no difference in what sort of industrial process each particular promise originated; as promises they are all homogeneous and equal. In paying for a carload of glucose, a purchaser might well use a note that had originated in the industry of iron-smelting, for instance. There is nothing necessarily on the face of the note to indicate in what sort of an industry it arose.

To the economist the utility of excluding everything specific from contracts for production, except the promise to pay money, is entirely different from the utility of the same exclusion as it appeals to the lawyer. The lawyer is called upon only when the contract is broken, and when the old note has not been taken up by a new one. The nice adjustment of industry having been disturbed, a section of it, or a particular business or firm, at least, has found its career interrupted. Its situation is no longer in harmony with the general system, and its future must be worked out by forced liquidation instead of by a customary and voluntary one. The particular business is thrown out of the higher, more psychic, environment to which it normally belongs, and a halt must be called for an adjustment of the threatened or actual injury to the rights of others involved. The forced liquidation remands the temporary conduct of the business to a lower environment. In the courts of law a suit is brought for money; and yet the delicate and professional operations of the law do not result necessarily in a payment of money. In a case of judgment, execution, and sale — certainly in most of the cases where large values are

involved — the purchaser from sheriff or receiver meets with no demand for actual money, but is permitted to pay with a certified check. Thus again it holds true that commercial paper corresponds to transactions in goods, whether forced or voluntary. The generalization and perfect fluidity of commercial paper, even in the case of business failure and consequent obstruction, avoid both inflation and contraction. Commercial paper constitutes — on our supposition, so far at least, for we have hitherto avoided speaking specially of the function of banks — practically the whole circulation of industry. It is created *pari passu* with the creation of goods; it lasts as long as they last; and it is renewed when they are further created. It expresses the pure income of the country in its most general and abstract form.

The banks have hitherto been omitted from our account. As a matter of fact, the banks play a most important part in the generalization of industrial promises. But it was not necessary to mention them up to this point, since they constitute merely a special, additional guaranty institution in the process of generalization. For the purpose of our quest, however, they now step upon the scene as the great means by which individual savings are socialized and put at the disposal of new enterprise. A word, therefore, in the first place, as to the part played by the banks in generalization of credit.

In most cases our typical manufacturer does not pass his contract for the sale of finished goods — his debtor's note — over to his creditor, the purveyor of raw materials. He does not compel his debtor to attorn to his creditor. The knowledge which the latter has of the solvency of other enterprises is not necessarily very extended. He is not satisfied with the confidential information furnished by a Bradstreet's or a Dun's Agency as to the solvency and business standing of persons with whom he has no direct transactions. For the purpose of security the seller of the raw materials requires perhaps a guarantor who will assume the whole risk so that he will not be called upon to make good a loss in the further career of the note. The discounting of commercial paper by a bank is, socially speaking, an operation

of guaranty. It is the banker's business to acquaint himself thoroughly with the solvency of the circle in which he operates. In return for a payment called "interest," he is willing to exchange his demand notes for the time notes of purchasers of goods. Since this operation is purely one of exchange of promises, it can in the normal case neither increase nor decrease the amount of commercial promises in circulation. It therefore affects in no way the parallelism of promises and goods that has already been described, except to render enormously more perfect the process of generalization and socialization of promises. For since the banker is a dealer in promises and a specialist in the business of guaranteeing them, having for the latter purpose a reserve of legal money (and, if the bank be a corporation, a large number of responsible stockholders), his demand promises are much more readily accepted than the time promises of purchasers. Moreover, the time promises for which he exchanges his demand promises remain generally in his portfolio, so that he subtracts from the money market as much as he adds to it; and in case he rediscounts the contents of his portfolio, that operation may well be performed in view of an unusual amount of exchanges of goods, to make which would normally require an additional amount of circulating medium.

But we have sufficiently explained the generalization of promises; and the banker has been introduced, not because of his importance in this matter, but on account of his importance in putting the promises of the community at the service of new enterprise. This weighty function of the banker would be impossible, were it not for the fact that he has at his disposal the homogeneous and generalized promises of industry.

Having shown the method by which promises arising in all sorts of businesses are rendered homogeneous and reduced to one common mass somewhat on the principle of the grading of grain, it would seem but a simple and easy step to say that the banks put these promises at the disposal of the great promoters, and to regard this as a sufficient explanation. But it is far from sufficient. There are a mechanism and a biology belonging to the

process, and without a description of these we are indulging in mere assertion — a mere unproven guess or empirical commonplace.

The profits of mere speculation — that is to say, of holding goods temporarily for a rise — are chiefly a transfer of wealth from one man's pocket to another's. Leaving such profits out of account, let us consider the more normal profits that result from the manufacture of goods, and which accompany the creation of an additional amount of wealth. The specific goods that correspond to the surplus wealth are not set off from other goods — from those whose value is simply sufficient to replace the destruction of raw materials, machinery, and the wear and tear of labor. All goods enter into the special technical processes or the special consumption for which they were designed. The eater of an oyster at Fulton Market has no means of knowing whether that is a surplus oyster or merely an up-keep oyster. The distinction between surplus and up-keep is made, not in the technical materialistic environment of manufacture, but in the psychic environment of finance. The bookkeeping of our typical manufacturer shows at a glance whether he has anything left over. His bank account may show the same thing. Of course, an up-to-date firm does a lot of financing on its own account, without saying "by your leave" to the banks. But, in most cases, a considerable balance is left with the bank. Here again, as in the case of the material goods, it is not possible to say whether the bank balance specifically represents the profits or surplus wealth of the firm. But it is safe to say that a firm that is not making profits will not be able to keep a large balance at the bank. In general it works that way, although sometimes the firms that make the largest profits keep the smallest balances. A bank balance consists of demand debts owed by the bank to the firm — our manufacturer, for example — and originates in the promises of others sent into the bank by him "for deposit," whether sight demands on other banks or discounted time paper, with which he has purchased his own bank's promises. The purchasers of goods, who thus have enabled our firm to make a deposit, were in turn enabled to do so

by deposits obtained at *their* banks in precisely the same way, and so on *ad infinitum*.

These deposits are all shifted about, for they are homogeneous and effect a large mass of the exchanges of society. If all debts were paid off, the deposits would offset each other; in other words, the banks would owe each other as much as they are owed; the business of banking would cease; and hence a most notable receptacle and distributer of modern business profits would disappear. It is because debts are continually renewed by the renewal of contracts of production, that a general mass of deposits unpaid exists. The bank deposits therefore represent the mass of moving indebtedness, so far as that is necessary to keep up the renewal of business and the renewed production of goods, or at least that portion of that indebtedness which it is necessary to convert into the most generalized form known as demand bank obligations.

It has already been shown that this mass of financial promises will be found only in the presence of profitable business. A permanent mass of deposits — not those that are drawn out as soon as they are put in, but those which, in spite of all the drawing out which takes place, still leave a permanent surplus — represents, on the whole, a part of the profits of industry. This plus balance is an average result of the infinite complexity of individual business management. It is not the result of leaving capital idle so much as the result of the rapidity of the accretions. A sort of actuarial average is established. The deposits of no one firm correspond to the average, but the average itself represents the disturbance in the moving equilibrium of industry in favor of a surplus of material wealth. In other words, the surplus of new goods creates a surplus of new promises which are always more than capable of taking up the promises that have run out. These bank deposits then, to a certain extent at least, represent the surplus goods manufactured by society. They do not represent any specific goods, but they normally correspond nevertheless to actual goods, and they amount to a declaration that those goods constitute a social surplus of wealth. Here we find two degrees of generalization: (*a*) the goods themselves are so generalized that

it is impossible to tell which of them represent the specific surplus; (*b*) the promises themselves are so generalized that it is impossible to tell which of them represent specific goods. These promises thus generalized are the very means by which those graded goods are circulated and devoted to a specific use. The promises have been completely dissociated from specific goods in the course of production. In this process they have lost none of their power of purchasing; on the contrary, they have gained enormously in circulating power with the gain in generalization.

Here are present all the conditions for the direction of goods into new enterprises: on the one hand, we have the surplus goods; on the other hand, we have automatically created a corresponding amount of purchasing power, any portion of which may be devoted to the directing of any portion of the goods into a new enterprise. Apparently, it only remains for institutions and persons to emerge upon the scene who shall perform the remaining function of using the promises to direct the goods whither they should go for the highest social economic productiveness.

We are now in better position to make the acquaintance of the promoter. It is well known that the small banks deposit with the larger banks, and those with still larger ones, until the financial center of the country is reached. This system of redepositing holds true, with variations of detail, for every country which possesses a financial system. In other words, a bank, relying on its high actuarial range of deposits, sends on to a more central bank some of the paper which it has purchased with those deposits, and with the paper purchases deposits of its own. While this operation does not reduce the accounts of its depositors, it amounts to the sending of the same grade of credit, since the guaranty of the funds which it sends for deposit to the central bank is precisely the same as the guaranty which gives currency to the deposits of its own depositors. At the central bank the deposit which we have been following receives the sanction and guaranty of that bank. The operation may be repeated now by the latter bank sending to a more central bank, and so on, until the final center is reached. Each redeposit involves an additional guar-

anty, and that means a further and higher generalization of business promises.

The central bank is thus put in possession of promises originating in the commonplace materialistic transactions of manufacture and production which have been reguaranteed and regeneralized repeatedly, and which are now for a time left at its disposal. In them it possesses a power of command over goods that is well-nigh irresistible — a power that can be compared to electric force alone, and which is of the highest tension. Put at the disposal of the stock market, it stimulates speculation in the new industrial ventures that are placed upon that market. Put at the disposal of promoters, these promises launch the new undertakings which absorb the new capital of the country.

We can now understand why these financial promises are called "capital." The fact is that the technical, materialistic capital of the country is an undistinguishable mass in which new and old wealth are inextricably commingled. It is only the financial capital, through the system of the money market, of the banks, and of the process of guaranty and generalization, which is able to sort out the new from the old and to put it at the disposal of enterprise.

We have now emerged from the dark continent of financial organization and have reached plain going. The function of the promoter and his methods of operation are well known and much discussed, and also those of underwriting new enterprises. We do not need to dwell upon them here. They have their good and their bad sides. They represent both the necessity of organizing new enterprises and the demand of the public to be gulled. But it is not the promoter himself that comes directly in contact with the potent current of highest purchasing power. It is in the underwriting or guaranteeing of his projects that the contact is made. The underwriting is performed by banks of the great financial centers, and this means that the projects of the promoters are guaranteed by the persons having naturally under their control the most generalized and highly guaranteed promises, without

which the banks would be impotent and their final and last guaranty would not be worth the paper on which it is written.

Our task is not finished until the investments are made. It is one thing to possess a surplus of wealth and to intend to invest it; it is another thing to make the final investment. The process of underwriting is not a process of investment. Underwriting simply signifies a highly matured stage of the social intention to invest. It enables the project to be put upon its feet as a going concern, but only keeps it a-going for a while. The underwriters are on probation. They have made a venture in the expectation of permanent support. The high-tension promises are at their command only temporarily. The moving of crops, the payment of international indebtedness, a slacking up of business, deprive them of power by withdrawal of balances from the money center. The many times guaranteed deposits may suddenly vanish. The guaranties are withdrawn. The electric current loses its tension, and is reabsorbed toward the boilers and furnaces of industry whence it originally departed.

In order to complete the investment, the securities must be sold, and the first operation is to list them on the stock exchange. The public buys — with what? With deposits. Deposits are withdrawn from banks of every grade, including the primary country banks. This purchase of securities by the public therefore withdraws deposits all along the line, including those upon which the underwriter relied. He is glad to lose his deposits in this way. The original holders of the promises have a string attached to them: they draw their promises back and invest them in the new securities.[3] The financial operation is now complete.

[3] All great financial establishments concentrate and guarantee promises. The chief difference between them and banks, from the underwriter's point of view, is that in their case the original provincial promises are not so easily and directly withdrawn by the original promisees, and thus the public's control of promotion through these establishments is not so efficient as that through banks. Recent developments in connection with a great life-insurance company invite the application of the law of trusts rather than that of banking. The insurance companies, indeed, are said to be great *purchasers* of high-grade new issues, especially those of international character.

Promoter and underwriter have light hearts. They are now relieved of a vast responsibility, which they had assumed temporarily, supported by the mass of fugitive deposits at the money center, but which now is assumed permanently by the public. The public thus advances economic power tentatively to the underwriters and promoters, leaving the responsibility with the latter. A period of probation ensues. If the public approves, it takes over the responsibility definitely upon itself. If it does not approve, they are left to weather the gale with their private fortunes as best they may. In the language of the " Street," they are left " to hold the baby;" and it is the opinion of competent observers that this is what happened in Wall Street during the year 1903.

The deposits have been traded for securities and, with some notable subtractions in the way of commissions, with which we need not concern ourselves, have been passed over to the manufacturers. The latter have used them in the purchase of machinery and materials, and thus at last the surplus materials have passed out of circulation and been incorporated into fixed capital to begin the round of production again, while the deposits can be kept alive in their original amount only in case the production of the new investments justifies that amount of productive promises. The deposits have entered again into the ordinary career of the bank surplus, and will be canceled if their final liquidation is necessary on account of the ill-success of enterprise. The securities now represent in permanent form the deposits with which they were purchased. But if the surplus production of the new enterprise does not correspond to the expected value, the securities, of course, will shrink in their power to purchase present goods. With their further career, however, we are not here concerned. In effect, the circulating goods are now merged into fixed capital, and the deposits are merged into investment securities. If they appear to circulate further, that is because they are supported by further production, and its parallel creation of mercantile paper.

The circulating medium of commercial paper which we first had in mind was short-time paper. Its value was the discounted

value of a *limited* number of future payments — of principal and interest upon it. The securities at which we are now arrived represent the discounted value of an *infinite* series of expected returns. The process of investment therefore is a procss of transmuting short-time terminable present values into long-time present values of the most permanent sort. On its physical side, the process is that of transmuting goods which give returns on a single operation into goods which give returns on an indefinite number of operations. But the latter operations produce new goods, which represent a new surplus capable of starting the original process of investment into motion again.

For financial operations a physical guaranty is always merely incidental. It is well known that the banker guarantees his generalization of credit by means of the cash reserve — in the simplest case a reserve of gold. Coming down farther to the more physical plane of the business of selling manufactured goods, the manufacturer, or his agent the jobber, guarantees his operations with the bank by his circulating capital; and coming down still farther on the physical plane, to the technical process of manufacturing, the promoter and underwriter guarantee their operations with the public by the fixed capital which is represented by the securities sold. Industry therefore is carried on in a succession of environments more or less advanced in the psychic scale from the most technical and physical to the most intellectual and psychic — the purely financial.

The process of financiering, itself the most potent department in the science of economic progress, has thus been presented in what may be called comparatively its most static or normal form. The reader will only too readily suggest aberrations which involve investment in the greatest uncertainty. Nevertheless, the machinery of financiering, whatever may be the results to the investor, works with remarkable safety and accuracy. The persons that launch great undertakings make use of the funds of the saving public from an early stage of their planning. The whole financial system has so developed and evolved as to encourage this method

of procedure. Looked at in this way, the men of finance seem to have been placed at a very important and critical point in a system that has developed spontaneously. Naturally, they are possessed of large private fortunes — small compared with the vast social funds placed at their disposal, but often large compared with those of other people. Here again we find a case of guaranty: it is not to be supposed that the public would make the advances which it does unless it were dealing with a class of persons themselves of unusual responsibility, who, by their wealth, are able to offer guaranty of good faith. Indeed, when irresponsible adventurers seize the helm of enterprise, the matter becomes cause for just complaint and public indignation. If faith is violated, however, it is human nature and extraneous interference, rather than the financial system, which are to be blamed.

Through the mechanism which has been described, the enormous and growing financial power, which has its origin in the production of goods, is gradually disengaged from them, purified, and concentrated by passing through a series of ascending psychic environments, until, reaching the highest financial center, it finishes its career by an imperative act of new investment, and is merged into the permanent form of securities, and through and by them is again associated closely with goods in a new technical process of production. The cycle of the economic organism is full-drawn by the energy of high finance.

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